THE BUSINESS LAWYER
Section of Business Law • American Bar Association

Reinterpreting Section 141(e) of Delaware's General Corporation Law: Why Interested Directors Should Be "Fully Protected" in Relying on Expert Advice

*By Thomas A. Uebler**

Directors of Delaware corporations often rely on lawyers, economists, investment bankers, professors, and many other experts in order to exercise their managerial power consistently with their fiduciary duties. Such reliance is encouraged by section 141(e) of the General Corporation Law of the State of Delaware, which states in part that directors "shall . . . be fully protected" in reasonably relying in good faith on expert advice. Section 141(e) should provide all directors of Delaware corporations a defense to liability if, in their capacity as directors, they reasonably relied in good faith on expert advice but nevertheless produced a transaction that is found to be unfair to the corporation or its stockholders, as long as the unfair aspect of the transaction arose from the expert advice. The Delaware Court of Chancery, however, has limited the full protection of section 141(e) by confining it to disinterested directors in duty of care cases. That limitation, which is not expressed in the statute, unfairly punishes interested directors who act with an honesty of purpose and reasonably rely in good faith on expert advice because it requires them to serve as guarantors of potentially flawed expert advice. This Article concludes that Delaware courts should reconsider the application and effect of section 141(e) and allow directors, regardless of their interest in a challenged transaction, to assert section 141(e) as a defense to liability in duty of care and duty of loyalty cases if they reasonably relied in good faith on expert advice.

I. Introduction

Delaware law vests the power to manage the business and affairs of a corporation with the corporation's board of directors.[1] Directors, however, cannot be expected to possess the qualifications or experience necessary to address every issue that arises in today's increasingly complex business world. To exercise their managerial power consistently with their fiduciary duties, directors of Delaware corporations

* Associate, Richards, Layton & Finger, P.A., Wilmington, Delaware. The opinions expressed in this Article are mine and not necessarily those of Richards, Layton & Finger or its clients. I thank R. Franklin Balotti for providing the original topic. I thank the Honorable Leo E. Strine, Jr., Mr. Balotti, Thomas A. Beck, William J. Haubert, Scott W. Perkins, Blake Rohrbacher, and E. Alan Uebler for their helpful and insightful comments.

1. *See* Del. Code Ann. tit. 8, § 141(a) (2001) ("The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors . . . .").

are often compelled to rely on lawyers, economists, investment bankers, professors, and many other experts to advise them in connection with board actions.[2] This is particularly true with respect to valuing an entity, which is a "subjective and uncertain enterprise."[3] Valuation is just one example of the important role that experts may play in the functioning of a corporation's board of directors.

For more than six decades, Delaware law has offered full protection to directors who are compelled to rely on expert advice to perform their directorial duties. Section 141(e) of the General Corporation Law states that:

> A member of the board of directors, or a member of any committee designated by the board of directors, shall, in the performance of such member's duties, be fully protected in relying in good faith upon the records of the corporation and upon such information, opinions, reports or statements presented to the corporation by any of the corporation's officers or employees, or committees of the board of directors, or by any other person as to matters the member reasonably believes are within such other person's professional or expert competence and who has been selected with reasonable care by or on behalf of the corporation.[4]

2. *See, e.g.*, Ash v. McCall, No. 17132, 2000 WL 1370341, at *9 (Del. Ch. Sept. 15, 2000) ("Directors of Delaware corporations quite properly delegate responsibility to qualified experts in a host of circumstances." (citing DEL. CODE ANN. tit. 8, § 141(e)) (emphasis omitted); *In re* W. Nat'l Corp. S'holders Litig., No. 15927, 2000 WL 710192, at *23 (Del. Ch. May 22, 2000) ("[A]s a legal and practical proposition, the Special Committee could and did reasonably rely on its expert advisor to obtain and analyze the specific information needed to value the Company." (citing DEL. CODE ANN. tit. 8, § 141(e))); *In re* RJR Nabisco, Inc. S'holders Litig., No. 10389, 1989 WL 7036, at *16 (Del. Ch. Jan. 31, 1989) ("Our law, of course, recognizes the appropriateness of directors relying upon the advice of experts when specialized judgment is necessary as part of a business judgment." (citing DEL. CODE ANN. tit. 8, § 141(e))).

3. *In re* 3Com S'holders Litig., No. 5067-CC, 2009 WL 5173804, at *6 (Del. Ch. Dec. 18, 2009) ("Valuing a company as a going concern is a subjective and uncertain enterprise."). "Professors Allen and Kraakman have also noted the institutional disinclination of Chancery judges to engage in the valuation process in certain circumstances precisely because those judges recognize it as a 'daunting task' subject to significant uncertainty." Cede & Co. v. Technicolor, Inc., No. 7129, 2003 WL 23700218, at *2 (Del. Ch. Dec. 31, 2003) (citing WILLIAM T. ALLEN & REINIER KRAAKMAN, COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATION 312 (2003)). *See also* Prescott Group Small Cap, L.P. v. Coleman Co., No. 17802, 2004 WL 2059515, at *31 (Del. Ch. Sept. 8, 2004) ("[T]he task of enterprise valuation, even for a finance expert, is fraught with uncertainty. For a lay person, even one who wears judicial robes, it is even more so."); *Cede*, 2003 WL 23700218, at *2 ("[I]t is one of the conceits of our law that we purport to declare something as elusive as *the* fair value of an entity on a given date . . . . Experience in the adversarial, battle of the experts' appraisal process under Delaware law teaches one lesson very clearly: valuation decisions are impossible to make with anything approaching complete confidence. Valuing an entity is a difficult intellectual exercise, especially when business and financial experts are able to organize data in support of wildly divergent valuations for the same entity. For a judge who is not an expert in corporate finance, one can do little more than try to detect gross distortions in the experts' opinions. This effort should, therefore, not be understood, as a matter of intellectual honesty, as resulting in *the* fair value of a corporation on a given date. The value of a corporation is not a point on a line, but a range of reasonable values, and the judge's task is to assign one particular value within this range as the most reasonable value in light of all of the relevant evidence and based on considerations of fairness.").

4. DEL. CODE ANN. tit. 8, § 141(e) (2001). Many other states, often guided by the Revised Model Business Corporation Act, have adopted statutory provisions similar to section 141(e). *See generally* MODEL BUS. CORP. ACT ANN. § 8.30(f)(2) (1984) ("A director is entitled to rely . . . on . . . legal counsel, public accountants, or other persons retained by the corporation as to matters involving skills or

Section 141(e) should be interpreted to provide all directors of Delaware corporations a defense to liability if, in their capacity as directors, they reasonably relied in good faith on expert advice but nevertheless produced an unfair transaction, as long as the unfair aspect of the transaction arose from the expert advice.[5]

The Delaware Court of Chancery, however, has limited the full protection of section 141(e) by confining it to duty of care cases.[6] The court appears to have taken the position that directors who are interested in a transaction may not invoke section 141(e) as a defense to liability. Thus, section 141(e) has been rejected as a defense in duty of loyalty cases. Perhaps the court has confined the protection of section 141(e) to duty of care cases to avoid protecting fiduciaries who have benefited from a transaction that is unfair to the corporation or its stockholders. That is a legitimate concern,[7] but it is not what the statute instructs. Section 141(e) is not limited by its terms to disinterested directors in duty of care cases.

By confining section 141(e) to duty of care cases, the court is not fulfilling the Delaware General Assembly's promise of full protection, and it risks punishing directors who act with an honesty of purpose but, despite their good-faith efforts, produce a transaction that later is found to be unfair. Directors who act with an honesty of purpose, even those who are deemed to be interested, should not be required to serve as guarantors of the expert advice that they reasonably rely upon in good faith. Put another way, directors should not be punished because an otherwise-qualified expert's advice is found in hindsight to have been flawed. If a challenged transaction is found to be unfair, but the defendant-directors reasonably relied in good faith on expert advice and the unfair aspect of the transaction arose from that advice, the directors should be exculpated from liability regardless

expertise the director reasonably believes are matters (i) within the particular person's professional or expert competence or (ii) as to which the particular person merits confidence."). In its discussion of Delaware's section 141(e), the commentary to section 8.30 of the MBCA notes that "[e]ight other jurisdictions similarly provide that a director is immune from liability for certain acts if he relied on information from officers, employees, or professionals." *Id.* at 8-210 to 8-211 ("Statutory Comparison").

5. Although section 141(e) also permits reliance on corporate records and opinions, reports, and statements of officers, employees, and board committees, I focus in this Article exclusively on reliance on experts.

6. I refer to "duty of care" cases as those in which disinterested and independent directors are alleged to have acted negligently in the exercise of their business judgment. I refer to "duty of loyalty" cases as those in which at least one director is alleged to be interested in a corporate transaction, or to be not independent of an interested person, and the transaction was not approved by disinterested and independent directors who comprise a majority of the directors who voted in connection with the transaction. *See* Chaffin v. GNI Group, Inc., No. 16211-NC, 1999 WL 721569, at *5–6 (Del. Ch. Sept. 3, 1999). See *infra* Part II.A.1 for a summary of the duty of care, and Part II.B.1 for a summary of the duty of loyalty.

7. Any perception by the public or by the U.S. Congress that Delaware is exonerating interested directors from personal liability, particularly in the post-Enron, post-WorldCom, and post-economic-crisis era, has potential political implications with respect to the threat of federalization of corporate law. This Article, however, does not propose a radical departure from existing law that would further exonerate directors from liability; it proposes only that existing law be given its plain meaning. Under the approach suggested in this Article, only directors who act in subjective good faith and with objective reasonableness would be protected from liability, and no director would unfairly profit at the expense of a corporation or its stockholders.

of any interest in the transaction. The defense should therefore be available to directors in both duty of care and duty of loyalty cases.

Part II summarizes Delaware law regarding the application and effect of section 141(e) in duty of care and duty of loyalty cases. Part III proposes an approach to section 141(e) that is consistent with the terms of the statute, its legislative history, the Delaware General Assembly's policies, and fairness to directors who act with an honesty of purpose. Part III also discusses *In re PNB Holding Co. Shareholders Litigation*[8] to illustrate how section 141(e) could operate as a defense in duty of loyalty cases. Part IV concludes that the Delaware courts should reconsider the application and effect of section 141(e) and allow directors to assert section 141(e) as a defense to liability in duty of care and duty of loyalty cases if they reasonably relied in good faith on expert advice but nevertheless produced an unfair transaction, as long as the unfair aspect of the transaction arose from the expert advice.

II. The Application and Effect of Section 141(e) Under Delaware Law

The application and effect of section 141(e) depends largely upon the type of case (i.e., duty of care or duty of loyalty), the applicable standard of judicial review,[9] and the procedural posture in which the statute is invoked. This Part summarizes the fiduciary duties of care and loyalty, which are the standards of conduct governing directors of Delaware corporations; summarizes the common-law entire fairness standard of judicial review, under which corporate transactions and directors' conduct in connection with those transactions are scrutinized if a plaintiff rebuts the presumption of the business judgment rule; and discusses the circumstances under which the Delaware courts have applied (or, in some cases, rejected) section 141(e) as a defense to liability.

A. The Duty of Care

1. Overview of the Duty of Care

The duty of care "requires that directors of a Delaware corporation 'use that amount of care which ordinarily careful and prudent men would use in similar circumstances.'"[10] The duty of care generally concerns directors' decision-making process, not the substantive merits of their decisions.[11] Thus, directors must inform themselves, "prior to making a business decision, of all material information

8. No. 28-N, 2006 WL 2403999 (Del. Ch. Aug. 18, 2006).

9. "In corporate law, a judicial standard of review is a verbal expression that describes the task a court performs in determining whether action by corporate directors violated their fiduciary duty." William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., *Function over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 56 Bus. Law. 1287, 1295 (2001).

10. *In re* Walt Disney Co. Derivative Litig., 907 A.2d 693, 749 (Del. Ch. 2005) (quoting Graham v. Allis-Chalmers Mfg. Co., 188 A.2d 125, 130 (Del. 1963), *aff'd*, 906 A.2d 27 (Del. 2006)).

11. *Id.* at 749–50; *see also* Brehm v. Eisner, 746 A.2d 244, 264 (Del. 2000) ("Due care in the decisionmaking context is *process* due care only.").

reasonably available to them."[12] Directors will be held to have breached their duty of care based on their decision-making process only if a plaintiff proves that the directors acted with gross, not simple, negligence.[13] If they were reasonably informed, disinterested, independent, and acted in good faith, directors will be held to have breached their duty of care based on the substantive merits of a decision only if the decision cannot be "attributed to any rational business purpose."[14]

Under Delaware law, the business judgment rule creates a presumption that "in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company."[15] If the presumption is not rebutted, the court's inquiry effectively ends, and a board's decision will not be disturbed.[16] The presumption, however, "can be rebutted if the plaintiff shows that the directors breached their fiduciary duty of care or of loyalty or acted in bad faith."[17] Thus, if a plaintiff demonstrates that the directors acted with gross negligence in their decision-making process or that the substantive merits of their decision cannot be attributed to any rational business purpose, the Court of Chancery will engage in the least deferential and most searching of all of the corporate law standards of review: entire fairness.[18] The burden of proving entire fairness is generally placed on the defendant-directors.[19] Entire fairness

---

12. Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985) (quoting Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984)).

13. *Id*. at 873 (citing *Aronson*, 473 A.2d at 812).

14. Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971). If, however, directors were reasonably informed, disinterested, independent, and acted in good faith, "it is as a practical matter impossible that the resulting decision can be found irrational." Allen, Jacobs & Strine, *supra* note 9, at 1298; *cf*. Thomas A. Uebler, *Shareholder Police Power: Shareholders' Ability to Hold Directors Accountable for Intentional Violations of Law*, 33 Del. J. Corp. L. 199, 208–09 (2008) ("[B]ecause an unreasonable decision could theoretically fall within the outer bounds of rationality, it does not follow under Delaware law that an unreasonable decision . . . will always be irrational.").

15. *Aronson*, 473 A.2d at 812.

16. The policy rationale for the business judgment rule has been explained in the following way:

> Corporate directors of public companies typically have a very small proportionate ownership interest in their corporations and little or no incentive compensation. Thus, they enjoy (as residual owners) only a very small proportion of any "upside" gains earned by the corporation on risky investment projects. If, however, corporate directors were to be found liable for a corporate loss from a risky project on the ground that the investment was too risky (foolishly risky! stupidly risky! egregiously risky!—you supply the adverb), their liability would be joint and several for the whole loss (with I suppose a right of contribution). Given the scale of operation of modern public corporations, this stupefying disjunction between risk and reward for corporate directors threatens undesirable effects. Given this disjunction, only a very small probability of director liability based on "negligence", "inattention", "waste", etc., could induce a board to avoid authorizing risky investment projects to any extent! Obviously, it is in the shareholders' economic interest to offer sufficient protection to directors from liability for negligence, etc., to allow directors to conclude that, as a practical matter, there is no risk that, if they act in good faith and meet minimalist proceduralist standards of attention, they can face liability as a result of a business loss.

Gagliardi v. TriFoods Int'l, Inc., 683 A.2d 1049, 1052 (Del. Ch. 1996).

17. *In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 52 (Del. 2006).

18. *See* Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 370 (Del. 1993).

19. *See In re* Trados Inc. S'holder Litig., No. 1512-CC, 2009 WL 2225958, at *6 (Del. Ch. July 24, 2009) ("If the presumption of the rule is rebutted, then the burden of proving entire fairness shifts to the director defendants."). Under limited circumstances not relevant to this analysis, the burden

> can be proved only where the directors demonstrate their utmost good faith and the most scrupulous inherent fairness of the bargain. Entire fairness has two components: fair dealing and fair price. The two components of the entire fairness concept are not independent, but rather the fair dealing prong informs the court as to the fairness of the price obtained through that process. The court does not focus on the components individually, but determines entire fairness based on all aspects of the entire transaction. Fair dealing addresses the questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained. Fair price assures the transaction was substantively fair by examining the economic and financial considerations.[20]

If the defendant-directors cannot prove that the challenged transaction was entirely fair, they may be subject to, among other remedies, personal liability.

2. Section 141(e) and the Duty of Care

Under Delaware law, section 141(e) provides directors a defense to liability in duty of care cases. If a plaintiff's duty of care claim survives a motion to dismiss, putting aside any issues under section 102(b)(7) of the General Corporation Law,[21] section 141(e) allows defendant-directors to introduce evidence of reasonable and good-faith reliance on expert advice to preclude liability in the event the transaction at issue is found to be unfair. Section 141(e) also may be case dispositive at the motion to dismiss stage.

The Court of Chancery first recognized that section 141(e) may provide a defense to liability in *Cinerama, Inc. v. Technicolor, Inc.*,[22] which was a duty of care case. In that case, on appeal of the Court of Chancery's post-trial opinion, the Delaware Supreme Court held that the defendant-directors had breached their duty of care in connection with a two-step merger transaction under which a subsidiary of MacAndrews & Forbes Group, Inc. acquired all of the stock of Technicolor, Inc. for $23 per share.[23] Because the directors were held to have breached their duty of care, the Delaware Supreme Court remanded the action to the Court of Chancery with instructions to conduct an entire fairness analysis for purposes

---

of proving entire (un)fairness may be shifted to the plaintiff. *See* Kahn v. Lynch Commc'n Sys., Inc., 638 A.2d 1110, 1117 (Del. 1994) ("[A]n approval of the transaction by an independent committee of directors or an informed majority of minority shareholders shifts the burden of proof on the issue of fairness from the controlling or dominating shareholder to the challenging shareholder-plaintiff.").

20. Valeant Pharms. Int'l v. Jerney, 921 A.2d 732, 746 (Del. Ch. 2007) (internal quotations and footnotes omitted).

21. Del. Code Ann. tit. 8, § 102(b)(7) (2001). "Section 102(b)(7) allows companies to adopt a provision in their certificate that eliminates the personal liability of directors for monetary damages for breach of fiduciary duty as a director, except for, among other things, breaches of the duty of loyalty and acts or omissions not in good faith or which involve intentional misconduct." Ryan v. Gifford, No. 2213-CC, 2009 WL 18143, at *7 n.27 (Del. Ch. Jan. 2, 2009). "The Section 102(b)(7) bar may be raised on a Rule 12(b)(6) motion to dismiss." Malpiede v. Townson, 780 A.2d 1075, 1092 (Del. 2001). For further discussion of section 102(b)(7), see *infra* Part III.A.3.

22. 663 A.2d 1134 (Del. Ch. 1994), *aff'd*, 663 A.2d 1156 (Del. 1995).

23. *Cede*, 634 A.2d at 366 ("We adopt the court's presumed findings that the defendant directors were grossly negligent in failing to reach an informed decision when they approved the agreement of merger, and to have thereby breached their duty of care.").

of assessing director liability.[24] On remand, the chancellor held that the challenged transaction was entirely fair, and that the plaintiff was therefore not entitled to damages.[25] In reaching that conclusion, the chancellor found that the defendant-directors relied in good faith on expert legal advice in connection with the challenged transaction, and that such good-faith reliance was "a relevant factor in assessing overall fairness."[26]

He then stated, in dicta, citing section 141(e), that "it is arguable that the board's good faith reliance [on expert legal advice] may provide an independent basis for finding the directors not liable."[27] The "arguable" issue that the chancellor referred to with respect to section 141(e) was whether the 1987 amendment had created a new defense for directors by including expert *legal counsel* as qualifying experts under the statute (in which case the defendants would not be permitted to assert retroactively the defense based on pre-1987 reliance on legal counsel), or whether expert legal counsel had always been intended to be included as experts under the statute and the legislature merely clarified the statute in 1987 "to ensure that directors would receive that degree of liability protection that was intended to be supplied by § 141(e) as originally enacted."[28] The underlying assumption of the chancellor's analysis was that there were circumstances, even before the 1987

24. *Id.* at 373. In its post-trial opinion, the Court of Chancery had assumed without deciding that the defendant-directors breached their duty of care, but held them not liable because the plaintiff failed to demonstrate any injury caused by the alleged breach of fiduciary duty. Cinerama, Inc. v. Technicolor, Inc., No. 8353, 1991 WL 111134, at *3 (Del. Ch. June 24, 1991) ("[E]ven if a lapse of care is assumed, plaintiff is not entitled to a judgment on this record. That is because in this situation, where there is no self-dealing or other breach of loyalty, it is plaintiff's burden to establish by evidence that it was injured as a result of the board's action. This it has not done."). The Delaware Supreme Court rejected the Court of Chancery's causation and proof-of-injury requirements:

> The Chancellor's restatement of the [business judgment] rule—to require [the plaintiff] to prove a proximate cause relationship between the [defendant-directors'] presumed breach of [their] duty of care *and* the shareholder's resultant loss—is contrary to well-established Delaware precedent . . . .
>
> . . . .
>
> To inject a requirement of proof of injury into the [business judgment] rule's formulation for burden shifting purposes is to lose sight of the underlying purpose of the rule. . . . To require proof of injury as a component of the proof necessary to rebut the business judgment presumption would be to convert the burden shifting process from a threshold determination of the appropriate standard of review to a dispositive adjudication on the merits.
>
> This Court has consistently held that the breach of the duty of care, without any requirement of proof of injury, is sufficient to rebut the business judgment rule.

Cede, 634 A.2d at 367, 371. The supreme court held that once a plaintiff demonstrates a breach of the duty of care, proof of that breach, alone, shifts the burden to the defendant-directors to prove that, notwithstanding the breach, the challenged transaction was entirely fair. *Id.* at 371 ("A breach of either the duty of loyalty or the duty of care rebuts the presumption that the directors have acted in the best interests of the shareholders, and requires the directors to prove that the transaction was entirely fair."). For a discussion of *Cede* and its application of entire fairness review in a duty of care case, see Allen, Jacobs & Strine, *supra* note 9, at 1301–04.

25. *Cinerama*, 663 A.2d at 1140–42.

26. *Id.* at 1141.

27. *Id.* at 1142.

28. *Id.* In 1987, the statute was amended, in pertinent part, to include as an expert "any . . . person as to matters the member reasonably believes are within such other person's professional or expert

amendment, under which section 141(e) provided an independent basis for protecting directors from liability. Because the directors faced no threat of liability, the chancellor did not need to, nor did he, resolve the circumstances under which section 141(e) provided "an independent basis for finding directors not liable," stating, "I need not express an opinion on [the section 141(e) defense] as I conclude that in all events plaintiffs are not entitled to an award of damages on this record."[29] On appeal, the Delaware Supreme Court similarly declined to address the availability of section 141(e) as an independent defense to liability. It stated that "[i]n the absence of a finding of liability, this Court, like the Court of Chancery, need not express an opinion regarding the merit of the defendants' reliance on 8 *Del. C.* § 141(e), as amended in 1987, as an affirmative defense."[30]

Several years later, the chancellor clarified the protective effect of section 141(e) in duty of care cases, stating, "There can be no personal liability of a director for losses arising from 'illegal' transactions if a director were financially disinterested, acted in good faith, and relied on advice of counsel reasonably selected in authorizing a transaction."[31]

In addition to providing a defense to liability after a trial on the merits, section 141(e) may be case dispositive in duty of care cases at the motion to dismiss stage. A board of directors is generally entitled to a "presumption that it exercised proper business judgment, including proper reliance on experts."[32] Thus, where a complaint alleges that a board of directors breached its duty of care in connection with a corporate action *and* that an expert advised the board in its decision-

competence and who has been selected with reasonable care by or on behalf of the corporation." 66 Del. Laws 335 (1987). Before 1987, the statute expressly included as experts only "an independent certified public accountant, or . . . an appraiser selected with reasonable care by the board of directors or by any such committee." *See id. Cf.* Smith v. Van Gorkom, 488 A.2d 858, 881 n.22 (Del. 1985) ("[W]e are satisfied that in an appropriate factual context a proper exercise of business judgment may include, as one of its aspects, reasonable reliance upon the advice of counsel. This is wholly outside the statutory protections of 8 *Del. C.* § 141(e) involving reliance upon reports of officers, certain experts and books and records of the company."). Irrespective of the legislature's pre-1987 intent concerning who qualified as experts, however, "[t]he allowable outside experts now clearly include counsel as well as competent specialists in other disciplines." 1 R. Franklin Balotti & Jesse A. Finkelstein, The Delaware Law of Corporations & Business Organizations § 4.15[B], at 4-110 (3d ed. 2010).

29. *Cinerama*, 663 A.2d at 1142. The court, therefore, did not limit the application of section 141(e) in any way; it declined to reach the issue because of its finding of entire fairness.

30. Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1156, 1175 n.29 (Del. 1995).

31. Gagliardi v. TriFoods Int'l, Inc., 683 A.2d 1049, 1051 n.2 (Del. Ch. 1996); *see also* Crescent/Mach I Partners, L.P. v. Turner, 846 A.2d 963, 985 (Del. Ch. 2000) ("Section 141(e) of Delaware's corporation law provides that directors are protected from a breach of the duty of care 'when the directors reasonably believe the information upon which they rely has been presented by an expert selected with reasonable care and is within that person's professional or expert competence.'" (quoting *In re* Cheyenne Software, Inc. Stockholders Litig., No. 14941, 1996 WL 652765, at *2 (Del. Ch. Nov. 7, 1996))). *See also* Perlegos v. Atmel Corp., Nos. 2320-N & 2321-N, 2007 WL 475453, at *20 (Del. Ch. Feb. 8, 2007) ("The principle that directors should be protected when they act with due care in reasonably relying upon the competent advice of an expert is expressed in Section 141(e) of the DGCL . . . .").

32. Ash v. McCall, No. 17132, 2000 WL 1370341, at *9 (Del. Ch. Sept. 15, 2000).

making process, the complaint must also allege particularized facts that, if proved, would show that:

> (a) the directors did not in fact rely on the expert; (b) their reliance was not in good faith; (c) they did not reasonably believe that the expert's advice was within the expert's professional competence; (d) the expert was not selected with reasonable care by or on behalf of the corporation, and the faulty selection process was attributable to the directors; (e) the subject matter . . . that was material and reasonably available was so obvious that the board's failure to consider it was grossly negligent regardless of the expert's advice or lack of advice; or (f) that the decision of the Board was so unconscionable as to constitute waste or fraud.[33]

If a complaint alleges that the directors relied on expert advice but fails to allege sufficient particularized facts from one or more of these categories, it will be dismissed.[34] On the other hand, if a complaint does not allege that the directors received or relied upon expert advice in connection with the directors' alleged breach of the duty of care, section 141(e) has been construed as a defense for which evidence may be introduced at trial by the defendant-directors.[35]

33. Brehm v. Eisner, 746 A.2d 244, 262 (Del. 2000); *see also Ash*, 2000 WL 1370341, at *9 (dismissing due care claim where complaint "allege[d] that the . . . directors were advised by their experts . . . and that they relied on their expertise in conducting due diligence ancillary to the proposed merger" but did not allege particularized facts, based on the *Brehm* factors, to rebut the presumption of the business judgment rule).

34. *Brehm*, 746 A.2d at 262.

35. *See* Manzo v. Rite Aid Corp., No. 18451-NC, 2002 WL 31926606, at *3 n.7 (Del. Ch. Dec. 19, 2002) ("As the complaint does not include allegations regarding the reports of experts (other than co-defendant KPMG—allegedly an aider and abettor in the directors breaches of fiduciary duties), the protections of § 141(e) would constitute an affirmative defense for which evidence may be brought at trial. It cannot affect the ruling on a motion to dismiss because at this stage, the plaintiff's allegations must be taken as true, notwithstanding any defenses that may be raised in a trial on the merits."). Although the Court of Chancery described section 141(e) as an "affirmative defense" in *Manzo*, it is probably better to describe it as being "in the nature of" an affirmative defense. "An affirmative defense is '[a] defendant's assertion raising new facts and arguments that, if true, will defeat the plaintiff's . . . claim, even if all allegations in the complaint are true.'" Emerald Partners v. Berlin, 787 A.2d 85, 91–92 (Del. 2001) (quoting BLACK'S LAW DICTIONARY 430 (7th ed. 1999)). In *Emerald Partners*, the Delaware Supreme Court considered section 102(b)(7) to be "in the nature of an affirmative defense" because although that statute "does not operate to defeat the validity of a plaintiff's claim on the merits, it can operate to defeat the plaintiff's ability to recover monetary damages." *Id.* at 92. Like section 102(b)(7), section 141(e) cannot defeat a plaintiff's claim on the merits, but it can defeat a plaintiff's claim for damages. Moreover, because the statute is silent regarding the burden of proof, and because it is not listed among the affirmative defenses in Court of Chancery Rule 8, there is at least an argument, like there is for section 102(b)(7), that section 141(e) should be considered a statutory immunity, which would place the burden of proof on plaintiffs to disprove reasonable and good-faith reliance. Pursuant to the reasoning in *Emerald Partners*, however, I treat section 141(e), like section 102(b)(7), as being in the nature of an affirmative defense. This is consistent with the common-law reliance-on-expert-advice defense. *See* Douglas W. Hawes & Thomas J. Sherrard, *Reliance on Advice of Counsel as a Defense in Corporate and Securities Cases*, 62 VA. L. REV. 1, 66 (1976) ("Reliance on advice of counsel has traditionally been an affirmative defense, and, as such, it must be raised and proved by the defendant."). Even assuming that section 141(e) should be considered in the nature of an affirmative defense, it should not be subject to the strict pleading requirements of Rule 8 because it is not a Rule 8(c) defense. *See* DEL. CT. CH. R. 8(c). Thus, defendant-directors should be permitted to raise a section 141(e) defense even after the pleading stage as long as the plaintiff receives sufficient notice.

B. The Duty of Loyalty

1. Overview of the Duty of Loyalty

"[T]he duty of loyalty mandates that the best interest of the corporation and its shareholders takes precedence over any interest possessed by a director, officer or controlling shareholder and not shared by the stockholders generally."[36] The Delaware courts have long held that "[c]orporate officers and directors are not permitted to use their position of trust and confidence to further their private interests."[37] The "duty of loyalty is not limited to cases involving a financial or other cognizable fiduciary conflict of interest. It also encompasses cases where the fiduciary fails to act in good faith."[38] In *Disney*, the Delaware Supreme Court, citing the chancellor's post-trial opinion, provided three nonexclusive definitions of bad faith conduct: (i) "where the fiduciary intentionally acts with a purpose other than that of advancing the best interest of the corporation," (ii) "where the fiduciary acts with the intent to violate applicable positive law," or (iii) "where the fiduciary intentionally fails to act in the face of a known duty to act."[39]

The entire fairness standard of review, which "is, at its core, an inquiry designed to assess whether a self-dealing transaction should be respected or set aside in equity,"[40] generally applies in duty of loyalty cases.[41] Thus, once a plaintiff demonstrates that at least half of the directors are interested or not independent[42] of a person who is interested in the challenged transaction or that the directors failed

---

36. Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993). A director is generally considered "interested" in two instances:

> The first is when (1) a director personally receives a benefit (or suffers a detriment), (2) as a result of, or from, the challenged transaction, (3) which is not generally shared with (or suffered by) the other shareholders of his corporation, and (4) that benefit (or detriment) is of such subjective material significance to that particular director that it is reasonable to question whether that director objectively considered the advisability of the challenged transaction to the corporation and its shareholders. The second instance is when a director stands on both sides of the challenged transaction.

Orman v. Cullman, 794 A.2d 5, 25 n.50 (Del. Ch. 2002).

37. Schoon v. Smith, 953 A.2d 196, 206 (Del. 2008) (quoting Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939)).

38. Stone *ex rel*. AmSouth Bancorporation v. Ritter, 911 A.2d 362, 370 (Del. 2006). The duty "to act in good faith does not establish an independent fiduciary duty that stands on the same footing as the duties of care and loyalty." *Id*.

39. *In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 67 (Del. 2006) (citation omitted).

40. Venhill Ltd. P'ship *ex rel*. Stallkamp, No. 1866-VCS, 2008 WL 2270488, at *22 (Del. Ch. June 3, 2008).

41. *See* Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983) ("The requirement of fairness is unflinching in its demand that where one stands on both sides of a transaction, he has the burden of establishing its entire fairness, sufficient to pass the test of careful scrutiny by the courts."). The business judgment rule may apply to duty of loyalty claims in limited circumstances. *See In re* Wheelabrator Techs., Inc. S'holders Litig., 663 A.2d 1194, 1205 (Del. Ch. 1995) (applying business judgment rule to duty of loyalty claim where an interested transaction involving a noncontrolling stockholder with representatives on the board of directors was approved by a majority of disinterested stockholders).

42. "Independence"

> does not involve a question of whether the challenged director derives a benefit *from the transaction* that is not generally shared with the other shareholders. Rather, it involves an inquiry into

to act in good faith,[43] the directors must prove that, notwithstanding their alleged interest or bad faith conduct, the challenged transaction is entirely fair to the corporation and its stockholders.

2. Section 141(e) and the Duty of Loyalty

Under the Court of Chancery's interpretation of section 141(e), reasonable, good-faith reliance on expert advice cannot preclude liability in duty of loyalty cases. In *Boyer v. Wilmington Materials, Inc.*,[44] the court explained:

> Iacono and Pettinaro argue that their "good faith reliance upon legal advice" provides a defense to them, citing [section 141(e) and *Cinerama*]. There is no dispute that Iacono and Pettinaro were both interested directors who gained by the sale of WMI's assets for less than fair value. In the circumstances, their reliance on the advice of [legal counsel] that the transaction was fair cannot shield them from liability to Boyer arising out of the unfairness of the transaction. I recognize that, in *Cinerama*, Chancellor Allen stated that "reasonable reliance on expert counsel is a pertinent factor in evaluating whether corporate directors have met a standard of fairness in their dealings with respect to corporate powers." Indeed, in this case, had the defendants chosen independent counsel to represent the interests of WMI, reliance on the advice of such counsel would have weighed in the assessment of procedural fairness. They did not. And, while Iacono and Pettinaro may have operated under the mistaken impression that [the legal counsel] represented their interests in connection with the transaction, they had no reason to believe that [the legal counsel] was representing WMI or its Board of Directors or had "been selected with reasonable care by or on behalf of the corporation." In the circumstances, the defense under Section 141(e) cannot be thought to be available.[45]

> whether the director's decision resulted from that director being *controlled* by another. A director can be controlled by another if in fact he is *dominated* by that other party, whether through close personal or familial relationship or through force of will. A director can also be controlled by another if the challenged director is *beholden* to the allegedly controlling entity. A director may be considered beholden to (and thus controlled by) another when the allegedly controlling entity has the unilateral power (whether direct or indirect through control over other decision makers), to decide whether the challenged director continues to receive a benefit, financial or otherwise, upon which the challenged director is so dependent or is of such subjective material importance to him that the threatened loss of that benefit might create a reason to question whether the controlled director is able to consider the corporate merits of the challenged transaction objectively.

Orman v. Cullman, 794 A.2d 5, 25 n.50 (Del. Ch. 2002).

43. In *Lyondell Chemical Co. v. Ryan*, the Delaware Supreme Court declined to draw a distinction between a "failure to act in good faith" and "bad faith." 970 A.2d 235, 240 n.8 (Del. 2009) ("Our corporate decisions tend to use the terms 'bad faith' and 'failure to act in good faith' interchangeably, although in a different context we noted that, '[t]he two concepts—bad faith and conduct not in good faith are not necessarily identical.'" (citation omitted)).

44. 754 A.2d 881 (Del. Ch. 1999).

45. *Id.* at 910–11 (citations omitted). To the extent section 141(e) was not available in *Boyer* because it was not reasonable for Iacono and Pettinaro to rely on *legal* experts, rather than on financial experts, to opine on the fairness of *price*, or because the legal counsel providing advice represented the interested directors in their personal capacity and not the corporation, the case is consistent with the approach to section 141(e) advocated here. I suggest, however, that it was incorrect to reject the defendant-directors' section 141(e) defense for the reason that "Iacono and Pettinaro were both interested directors who gained by the sale of WMI's assets for less than fair value." *Id.* at 910.

The court's rejection of the defendant-directors' section 141(e) defense in *Boyer* was relied upon in its more recent *Valeant* decision.

In *Valeant*, the defendant, Adam Jerney, a former director of ICN Pharmaceuticals, Inc., had voted with other former directors of the company[46] to award themselves cash bonuses in connection with a contemplated corporate restructuring.[47] The trial record left "no doubt that the decision to pay cash bonuses was ill-advised and was not entirely fair to the company. The process pursued by the directors was deeply flawed with self-interest and no way substituted for arm's-length bargaining."[48] Jerney argued that, under section 141(e), his reliance on the advice of a compensation consulting firm in connection with the challenged bonus plan provided a complete defense to liability.[49] The court rejected Jerney's section 141(e) defense, noting that Jerney could "point to no case where any court has held that section 141(e) provides a defense in an entire fairness action."[50] "This is particularly true," the court observed, "where the person claiming the defense . . . is interested in the challenged transaction."[51] According to the court, "[t]o hold otherwise would replace this court's role in determining entire fairness . . . with that of various experts hired to give advice to the directors in connection with the challenged transaction."[52] The *Valeant* court did not address the chancellor's observation in *Cinerama*, an entire fairness case, that "it is arguable that the board's good faith reliance [on expert legal advice] may provide an independent basis for finding the directors not liable."[53] However, the *Valeant* court did rely on *Cinerama*, stating, "Although 'reasonable reliance upon expert counsel is a pertinent *factor* in evaluating whether corporate directors have met a standard of fairness in their dealings with respect to corporate powers,' its existence is not outcome determinative of entire fairness."[54] Notwithstanding Jerney's purported reliance on expert advice, the court held that Jerney breached his duty of loyalty by approving the unfair, self-interested bonuses, and it required Jerney to disgorge his entire $3 million bonus, plus interest, and held him liable for additional monetary damages flowing from his breach of fiduciary duty.[55]

46. By the time the post-trial opinion was issued, all of the other defendant-directors had settled with the company.

47. Valeant Pharms. Int'l v. Jerney, 921 A.2d 732, 735 (Del. Ch. 2007).

48. *Id*. at 736.

49. *Id*. at 750–51.

50. *Id*. at 751.

51. *Id*. (citing *Boyer*, 754 A.2d at 910).

52. *Id*.

53. Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1134, 1142 (Del. Ch. 1994), *aff'd*, 663 A.2d 1156 (Del. 1995).

54. *Valeant*, 921 A.2d at 751 (quoting *Cinerama*, 663 A.2d at 1142). As also noted by the *Valeant* court, the Delaware Supreme Court, in affirming *Cinerama*, found that the Court of Chancery properly considered a board's reliance on experienced counsel as evidence of good faith and overall fairness of process. *Id*.

55. *Id*. at 736. Even if the *Valeant* court had considered section 141(e) as advocated here, the opinion suggests that the outcome would not have changed. The court expressly found that "it would have been unreasonable for Jerney to rely on [the Towers Perrin] report as an expert opinion as to the fairness of ICN's payment of $50 million in cash bonuses" because Towers Perrin was retained at the direction of management, its report addressed a different transaction from the one actually adopted,

Professor Hillary Sale cautioned after *Valeant* that the case "raises issues about § 141(e) and its effectiveness in insulating transactions."[56] Professor Stephen Bainbridge went further, explaining that "[b]y relegating a section 141(e) report to the status of a mere factor as a matter of law, . . . Vice Chancellor Lamb eviscerates the section."[57] Indeed, *Valeant* reaffirms that, to date, no Delaware court has held that section 141(e) may provide directors a defense to liability in duty of loyalty cases.[58]

III. Section 141(e) Should Provide Directors a Defense to Liability in Both Duty of Care and Duty of Loyalty Cases

Section 141(e) should provide directors, whether or not they are deemed to be interested, a defense to liability if they reasonably relied in good faith on expert advice but nevertheless produced an unfair transaction, as long as the unfair aspect of the transaction arose from the expert advice. This approach to the statute is fair because the mandatory elements of section 141(e) are sufficient to protect corporations and their stockholders from the unscrupulous director who could attempt to choreograph a trail of evidence that superficially demonstrates reliance on expert advice while knowing that the transaction from which he expects to profit is unfair.

The transactions most affected by this approach to section 141(e) would be interested-director transactions, particularly in private corporations, where they are more likely to occur and are sometimes necessary. Transactions between a parent and a subsidiary or transactions between a controlling stockholder and a corporation, on the other hand, should not be affected because section 141(e), by its terms, protects directors, not majority or controlling stockholders.[59] This

and its report was based on substantially inflated values. *Id.* at 751. Moreover, the court found that "it was not within the expertise of Fried Frank or any other independent counsel to opine as to the actual substantive fairness of the proposal." *Id.* The court's opinion is instructive because it suggests that (i) reasonableness of reliance may turn on whether flaws in an expert's opinion should have been apparent to defendant-directors at the time of their decision; (ii) it is not reasonable to rely on legal counsel's advice regarding substantive fairness of a transaction; and (iii) experts should be retained through an independent process, not at the direction of interested parties. *See id.*

56. Hillary A. Sale, *Monitoring* Caremark*'s Good Faith*, 32 Del. J. Corp. L. 719, 749 n.232 (2007).

57. ProfessorBainbridge.com, http://www.professorbainbridge.com/professorbainbridgecom/2007/04/eviscerating-dgcl-141e.html (Apr. 2, 2007, 9:34 PM) ("Eviscerating DGCL 141(e)"). To the extent Professor Bainbridge argues that section 141(e) should be outcome determinative of fairness ("The plain text of the statute . . . requires that such a report be outcome determinative."), I disagree. As discussed below, section 141(e) is a statutory doctrine with no role in entire fairness review. *See infra* notes 102–08 and accompanying text. Thus, reliance on an expert's report may be a factor indicative of fairness, but the report itself should not be determinative of fairness.

58. At least one non-Delaware court has questioned section 141(e)'s applicability in duty of loyalty cases. *See In re* Fleming Packaging Corp., 351 B.R. 626, 641 (Bankr. C.D. Ill. 2006) ("In this Court's view, [section 141(e)] appears to be a potential defense to a claim for breach of the duty of care. . . . Having found that the TRUSTEE has not asserted a duty of care claim, arguably, § 141(e) is not a valid defense to the TRUSTEE'S claims for breach of the duties of loyalty and good faith." (citing Official Comm. of Unsecured Creditors of Integrated Health Servs., Inc. v. Elkins, No. 20228-NC, 2004 WL 1949290 (Del. Ch. Aug. 24, 2004); Brehm v. Eisner, 746 A.2d 244 (Del. 2000))).

59. In *David J. Greene & Co. v. Dunhill International, Inc.*, on the plaintiffs' motion to enjoin a parent-subsidiary merger on the grounds that it was unfair to the subsidiary's minority stockholders, the defendant-parent corporation argued that its outside expert's fairness opinion was entitled

approach similarly would not offer much additional protection to directors considered "not independent" in connection with a particular transaction. Non-independent directors are generally only held liable for an unfair transaction where "they breached their duty of loyalty by approving the transaction in bad faith to benefit [the person controlling them], rather than in a good faith effort to benefit the corporation."[60] If a non-independent director acts in bad faith and is therefore subject to liability, it is unlikely that the director would simultaneously be able to prove good-faith reliance on expert advice. This Part discusses why, and how, section 141(e) should apply in duty of loyalty cases.

A. Section 141(e) Should Provide Directors a Defense to Liability in Duty of Loyalty Cases

That section 141(e) should provide directors a defense to liability in duty of loyalty cases is supported by the plain language of the statute, the Delaware General Assembly's policy that interested-director transactions can be beneficial to and sometimes necessary for corporations, section 141(e)'s interplay with other statutes under the General Corporation Law, and fairness to directors who act in good faith and with an honesty of purpose.

1. Section 141(e) Is Not Limited by Its Terms to Duty of Care Cases

Justice Felix Frankfurter once observed:

> A judge must not rewrite a statute, neither to enlarge nor to contract it. Whatever temptations the statesmanship of policy-making might wisely suggest, construction

to a presumption in its favor under section 141(e). 249 A.2d 427, 431 (Del. Ch. 1968). The court disagreed, stating that section 141(e) "'protects' directors relying in good faith upon certain reports made to the corporation, but it has no application here. Nor does it in any way weaken the requirements fixed by Sterling." *Id.* (citing Sterling v. Mayflower Hotel Corp., 89 A.2d 862, 867 (Del. Ch. 1952) (holding that a defendant-parent corporation must prove that the terms of a challenged parent-subsidiary merger are entirely fair to the minority stockholders)). *See also* Lynch v. Vickers Energy Corp., No. 4645, 1978 WL 5681, at *2–3 (Del. Ch. May 12, 1978) (stating that section 141(e) was inapplicable in *David J. Greene & Co*. because the directors of the parent corporation were not named as defendants and because the outside expert's fairness opinion was not a qualifying report under the version of the statute in effect at that time). Notwithstanding controlling stockholders' inability to assert section 141(e) as a defense, they should be permitted under the common law to demonstrate evidence of good-faith reliance on expert advice as a factor indicative of fairness under entire fairness review. *See* Hawes & Sherrard, *supra* note 35, at 55–56 ("Reliance on advice of counsel may also be relevant to assessing fiduciary duties of controlling shareholders. . . . While no cases have confronted this problem directly, it is fair to conclude that reliance will be a factor in determining whether a controlling shareholder has breached such a duty.").

60. Venhill Ltd. P'ship *ex rel*. Stallkamp, No. 1866-VCS, 2008 WL 2270488, at *23 (Del. Ch. June 3, 2008). If non-independent directors "acted in the good faith belief that they were pursuing the corporation's best interests—that is, with a loyal state of mind—their failure to procure a fair result does not expose them to liability . . . . In other words, their status as a relative of the self-dealing director is only a fact relevant to the ultimate determination whether they complied with their fiduciary duties, it is not a status crime making them a guarantor of the fairness of the transaction." *Id.* (footnote omitted).

> must eschew interpolation and evisceration. He must not read in by way of creation. He must not read out except to avoid patent nonsense or internal contradiction.[61]

Delaware law reflects the principles articulated by Justice Frankfurter.[62] The Delaware courts, therefore, should give effect to the plain and unambiguous terms of section 141(e)—directors "shall . . . be fully protected"[63]—without reading in an exception for interested or non-independent directors.

It would not be inconsistent with the apparent legislative purpose or intent of section 141(e) to give its terms their plain meaning. I have been unable to locate any legislative history suggesting that the statute, notwithstanding its plain and unambiguous terms, was intended to be limited to disinterested directors or to duty of care cases.[64] The Delaware General Assembly introduced section 141(e) more than sixty-five years ago by amending section 2041 of the Revised Code of Delaware of 1935 to provide that a director "shall in the performance of his duties be fully protected in relying in good faith upon . . . reports made to the corporation by any of its officials, or by an independent certified public accountant, or by an appraiser selected with reasonable care by the Board of Directors."[65] The General Corporation Law was revised significantly in 1967, but the 1943 amendment to section 2041, which by then had been reclassified as title 8, section 141(f), was "retained as is" under section 141(e).[66] Since then, "the changes in this statute have been in the nature of tinkering."[67] In 1987, the legislature amended section 141(e) to define qualifying experts as "any . . . person as to matters the [director] reasonably believes are within such other person's professional or expert competence and who has been selected with reasonable care by or on behalf of the corporation."[68] The purpose of the 1987 amendment was "to clarify that directors may rely in good faith upon all corporate records, reports of employees and committees of the board and the written or oral advice or opinions of any professionals

See also Allen, Jacobs & Strine, *supra* note 9, at 1318 ("If a director did not benefit from the unfair transaction, the plaintiff who seeks to subject that director to money damages liability should have the burden to prove that the director consciously breached his duties to the corporation.").

61. Felix Frankfurter, *Some Reflections on the Reading of Statutes*, 47 COLUM. L. REV. 527, 533 (1947).

62. *See, e.g.*, Seth v. State, 592 A.2d 436, 440 (Del. 1991) ("[W]hen statutory language is both clear and consistent with other provisions of the same legislation and with legislative purpose and intent, a court must give effect to that intent because it is for the legislature, and not the courts, to declare the public policy of the state."); Rubick v. Sec. Instrument Corp., 766 A.2d 15, 18 (Del. 2000) ("If the statute is unambiguous, there is no room for interpretation, and the plain meaning of the words controls.").

63. DEL. CODE ANN. tit. 8, § 141(e) (2001).

64. This is unsurprising considering that "before the 1980s the director's duty of care received little or no notice in Delaware." Allen, Jacobs & Strine, *supra* note 9, at 1290.

65. *See* 44 Del. Laws 422, 423 (1943).

66. *See* MINUTES OF EIGHTH MEETING OF DELAWARE CORPORATION LAW STUDY COMMITTEE (Jan. 13, 1965) ("141(f) to be retained as is.").

67. E. Norman Veasey & Christine T. Di Guglielmo, *What Happened in Delaware Corporate Law and Governance from 1992–2004? A Retrospective on Some Key Developments*, 153 U. PA. L. REV. 1399, 1443 n.166 (2005).

68. 66 Del. Laws 335 (1987).

and experts who are selected with reasonable care and are reasonably believed to be acting within the scope of their expertise."[69]

Some commentary even suggests that the protection of section 141(e) was not intended to be limited to disinterested directors or to duty of care cases. Professor Ernest Folk, who was instrumental in the 1967 revision of the General Corporation Law, appears to have assumed in his report to the Corporation Law Revision Committee that section 141(e) applied to interested-director transactions as well as disinterested transactions. In the section titled "Interested Director Transactions," which discussed circumstances under which interested-director transactions would be validated under section 144 of the General Corporation Law and not considered void or voidable, Professor Folk suggested:

> Although no state so far has done this, Delaware might break new ground by providing that a board of directors or shareholders act in "good faith," if they act upon findings by one or more of the following "independent" persons:
>
> (a) Independent appraisers of value. Statutory recognition of this would be particularly helpful in sustaining, for instance, a sale by director A to his corporation of items whose value necessarily involves estimates.
> (b) Independent certified public accountants.
> (c) Independent committee of directors, e.g., in making a determination of value on compensation, etc.
> (d) an opinion by independent counsel[,] e.g., as to circumstances entitling a person to indemnification, or a loan, etc.[70]

Folk then explained:

> *Section 141(f)* [the predecessor to Section 141(e)] *already "fully protects" directors from liability in like circumstances* and the above provision would similarly help sustain a contract or other transaction when challenged.[71]

Although Professor Folk did not expressly address the applicability of section 141(f), now section 141(e), to duty of loyalty cases, in context it appears that he believed that the statute protected directors from liability in connection with interested-director transactions where such directors acted in good faith.

2. Delaware Law Recognizes that Interested-Director Transactions Can Be Beneficial to and Sometimes Necessary for Corporations

As Professor Folk explained in his report to the Corporation Law Revision Committee, and the Delaware General Assembly recognized in its adoption of section 144, interested-director transactions can be beneficial to and sometimes necessary for corporations, particularly private corporations. Section 144,

69. *Id*. at 14 ("Official Commentary").
70. Ernest L. Folk, III, Review of the Delaware Corporation Law for the Delaware Corporation Law Revision Committee (1965–1967), at 75 (1968) (citation omitted).
71. *Id*. (emphasis added).

adopted in 1967, "validate[s] self-dealing transactions involving directors and officers when those transactions comply with any one of three statutory safeguards."[72] The procedures for validating interested-director transactions under section 144 were thought to be necessary to "fill a legitimate need in the efficient functioning of the corporate enterprise."[73] "Although useful to all corporations, they are absolutely essential to the close corporation, many of whose transactions necessarily involve conflicting interests . . . ."[74] It was Professor Folk's belief that section 144 would "deter many unwarranted challenges to bona fide interested director transactions."[75]

Although self-dealing invites skepticism, interested-director transactions are not only contemplated under Delaware law, but are encouraged where necessary. This practical reality and the legislative policy reflected in section 144 favor including interested-director transactions within the scope of transactions from which directors may seek protection from liability under section 141(e).[76]

3. Under Current Delaware Law, Section 102(b)(7) Effectively Renders Section 141(e) Superfluous

By confining the protection of section 141(e) to duty of care cases, the Court of Chancery has effectively rendered the statute superfluous. Most directors are already protected from liability for breaches of the duty of care under section 102(b)(7), which states:

72. R. Franklin Balotti, Donald A. Bussard & Thomas A. Uebler, *The (Mis)Application of Section 144*, Del. Law., Spring 2008, at 22, 22.

73. Folk, *supra* note 70, at 67 (quoting Sterling v. Mayflower Hotel Corp., 93 A.2d 107, 119 (Del. 1952)).

74. *Id*. Professor Folk further explained:

> Not infrequently corporations wish to enter into transactions with their directors or officers or with other corporations having common directors. Although common law originally forbade such transactions, the Delaware decisions recognized the validity of certain transactions of this kind subject to certain safeguards. [Section 144] specifically codifies the somewhat scattered case law into clear statutory rules which will be useful to all corporations but especially to the closely held enterprise, many of whose transactions necessarily involve potentially conflicting interests of directors and officers.

Ernest L. Folk, III, The New Delaware Corporation Law 10 (1967).

75. Folk, *supra* note 70, at 67.

76. To the extent *Valeant* suggests that the approach to section 141(e) advocated here would create a statutory conflict between sections 141(e) and 144, *see* Valeant Pharms. Int'l v. Jerney, 921 A.2d 732, 750–51 (Del. Ch. 2007), I disagree. To the contrary, "recognizing good faith reliance on the advice of experts as a defense to liability . . . would not create a statutory conflict because § 144 has no role in determining director liability." Balotti, Bussard & Uebler, *supra* note 72, at 22. Moreover, I suggest that neither section 141(e) nor section 144 has a role in a common-law breach of fiduciary duty analysis (i.e., common-law entire fairness review). *See generally* Blake Rohrbacher, John Mark Zeberkiewicz & Thomas A. Uebler, *Finding Safe Harbor: Clarifying the Limited Application of Section 144*, 33 Del. J. Corp. L. 719 (2008) (arguing that the purpose of section 144 is to validate interested-director transactions and that section 144 is not the source of, and has no connection with, a common-law breach of fiduciary duty analysis).

> (b) In addition to the matters required to be set forth in the certificate of incorporation by subsection (a) of this section, the certificate of incorporation may also contain any or all of the following matters:
>
> . . . .
>
> (7) A provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit the liability of a director: (i) For any breach of the director's duty of loyalty to the corporation or its stockholders; (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law; (iii) under § 174 of this title; or (iv) for any transaction from which the director derived an improper personal benefit.[77]

Although section 102(b)(7) is permissive, exculpatory provisions pursuant to it are commonly found in charters of Delaware corporations.[78] Even if a corporation has not adopted a section 102(b)(7) provision, the business judgment rule provides additional protection to directors in connection with allegations of breach of the duty of care. That is, even if a claim for monetary damages based on an alleged breach of the duty of care is not dismissed pursuant to section 102(b)(7), in order to rebut the business judgment rule, a plaintiff has the burden of proving that the defendant-directors acted with gross negligence.[79] This is a difficult burden because "[t]he definition of gross negligence used in [Delaware's] corporate law jurisprudence is extremely stringent."[80] And, at least under some circumstances, a plaintiff may also be required to produce evidence of injury caused by the alleged breach of the duty of care.[81] Thus, even setting aside the protection of

77. DEL. CODE ANN. tit. 8, § 102(b)(7) (2001).

78. *See In re* Walt Disney Co. Derivative Litig., 907 A.2d 693, 752 (Del. Ch. 2005) ("The vast majority of Delaware corporations have a provision in their certificate of incorporation that permits exculpation to the extent provided for by § 102(b)(7).").

79. *See In re* Lear Corp. S'holder Litig., 967 A.2d 640, 651–52 (Del. Ch. 2008) ("Even where it is possible to hold directors responsible for a breach of the duty of care, Delaware law requires that directors have acted with gross negligence.").

80. *Id.* at 652 (citing Tomczak v. Morton Thiokol, Inc., No. 7861, 1990 WL 42607, at *12 (Del. Ch. Apr. 5, 1990) ("[G]ross negligence means reckless indifference to or a deliberate disregard of the whole body of stockholders or actions which are without the bounds of reason." (internal quotations omitted)); Solash v. Telex Corp., 1988 WL 3587, at *9 (Del. Ch. Jan. 19, 1988) (to be grossly negligent, a "decision has to be so grossly off-the-mark as to amount to 'reckless indifference' or a 'gross abuse of discretion'" (citations omitted))).

81. *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345 (Del. 1993), has been interpreted by some as holding "(at least in the context of a merger or sale of the company) that if the acquired corporation's directors breach their duty of care in approving the terms of the transaction, as a theoretical matter, the plaintiff will have no burden to show that any such lapse caused injury." Allen, Jacobs & Strine, *supra* note 9, at 1302 (discussing *Cede*, 634 A.2d at 367, 371). This interpretation appears to leave open the possibility of requiring plaintiffs, in some non-merger circumstances, to produce evidence of causation and injury. Aside from the issue of proof of causation and injury, it is also unclear under *Cede* whether evidence of actual monetary damages would be required to impose liability for a breach of the duty of care. *See Cede*, 634 A.2d at 367 ("Under *Weinberger*'s entire fairness standard of review, a party may have a legally cognizable injury regardless of whether the tender offer and cash-out price is *greater than* the stock's fair value as determined for statutory appraisal purposes." (emphasis added)). *But see In re* J.P. Morgan Chase & Co. S'holder Litig., 906 A.2d 766, 773 (Del. 2006) (discussing "the fundamental principle governing entitlement to compensatory damages, which is that the damages must be logically and reasonably related to the harm or injury for which compensation is being awarded").

section 141(e), the chances of recovering monetary damages from directors under Delaware law for a breach of the duty of care are small.

Section 141(e) therefore has purpose only if it is available as a defense to interested directors in duty of loyalty cases. Otherwise, it was effectively supplanted by the adoption of section 102(b)(7) and the business judgment rule.[82]

4. It Is Fair to Protect Directors Who Act Reasonably and in Good Faith

Section 141(e) does not preclude liability in all instances where directors rely, or purport to rely, on expert advice. Rather, the statute precludes liability only where a transaction is found to be unfair but the directors nevertheless acted (i) reasonably and (ii) in good faith (iii) in relying on expert advice. And, although not expressly required under the statute, section 141(e) should preclude liability only if the unfair aspect of the transaction arose from the expert advice. Thus, to be protected under section 141(e), directors must satisfy an objective standard (reasonableness) and a subjective standard (good faith),[83] and failure to satisfy both standards is likely fatal to the defense.[84] The Court of Chancery is well suited

82. *Cf*. Desimone v. Barrows, 924 A.2d 908, 936 (Del. Ch. 2007) ("In this context, there would be no deception on the corporation's stockholders, as the directors would have fully disclosed why they made the award, and the compensation committee would seemingly be entitled to strong protection from *both* the § 102(b)(7) clause *and* § 141(e) of the Delaware General Corporation Law." (emphasis added)); Official Comm. of Unsecured Creditors of Integrated Health Servs., Inc. v. Elkins, No. 20228-NC, 2004 WL 1949290, at *13 n.64 (Del. Ch. Aug. 24, 2004) ("Because I find IHS's § 102(b)(7) provision shields Defendants from liability regarding the 1997 Loan Program, I do not reach arguments regarding 8 *Del. C*. § 141(e).").

83. *See* Grubb v. Bagley, No. 13882-NC, 1998 WL 92224, at *2 (Del. Ch. Feb. 25, 1998) ("The statute affords a defense only if the board acted reasonably and in good faith.").

84. *Cf*. Hawes & Sherrard, *supra* note 35, at 19 ("Generally speaking, reliance upon advice of counsel may serve as a defense . . . if the defendant in good faith and with care: (1) selected counsel he believed to be competent; (2) disclosed to counsel all facts which he believed to be relevant; (3) received erroneous advice on a matter of law; and (4) acted in accordance with such advice after it had been rendered. The ultimate success of the defense will depend upon a threshold showing of compliance with each element; accordingly, failure to prove any one factor may vitiate the defense entirely." (footnote omitted)).

Although beyond the scope of this Article, it should be noted that defendant-directors may be required to waive, or be deemed to have implicitly waived, the attorney-client privilege in connection with a section 141(e) defense that is based on reliance on the advice of counsel. *See, e.g*., Zirn v. VLI Corp., 621 A.2d 773, 782 (Del. 1993) ("A party should not be permitted to assert the [attorney-client] privilege to prevent inquiry by an opposing party where the professional advice, itself, is tendered as a defense or explanation for disputed conduct."); Chesapeake Corp. v. Shore, 771 A.2d 293, 304 (Del. Ch. 2000) ("Shorewood has blocked any inquiry into the nature of the legal advice given to its board and therefore the director-defendants cannot rely upon that advice to support their position in this litigation."); Trial Transcript at 505, Mentor Graphics Corp. v. Quickturn Design Sys., Inc., 728 A.2d 25 (Del. Ch. 1998) (No. 16584) ("[T]he defendants' tactical decision to bar on privileged grounds discovery into what the board was advised was their fiduciary duty and into the content of the board's deliberations will in turn preclude them from proving those deliberations at trial to defend their position that their decision was reasonable and made with due care."); *In re* Unitrin, Inc. S'holders Litig., Nos. 13656 & 13699, 1994 WL 507859, at *2 (Del. Ch. Sept. 7, 1994) ("I think it would be unfair to allow defendants to select those parts of its communications with counsel that can be used in these proceedings, while at the same time invoking the attorney-client privilege to thwart plaintiffs' effort to show that defendants improperly influenced the advice they received or to examine the factual basis for the advice.").

to determine from the record and live testimony whether directors acted reasonably and in good faith in any particular transaction and whether the unfair aspect of the challenged transaction arose from the flawed expert advice.[85]

a. Objective Reasonableness

Under section 141(e), a director may only rely on an expert "as to matters the member reasonably believes are within such other person's professional or expert competence and who has been selected with reasonable care by or on behalf of the corporation."[86] These elements of section 141(e) can be construed generally to require objective reasonableness as to the reliance under the circumstances.[87] If a challenged transaction is found to be unfair, a director must show why it was not unreasonable to rely on the expert based on all of the material information reasonably available at the time of the reliance.[88] In other words, directors cannot bury their heads in the sand and later claim that they were told the transaction was fair so it must have been so.[89] Rather, they must prove that they considered all material information reasonably available about the expert and the issue presented, and in the context of considering that information, it was reasonable to retain and rely upon that expert at the time of the

85. *See, e.g.*, Perlegos v. Atmel Corp., Nos. 2320-N & 2321-N, 2007 WL 475453, at *20 (Del. Ch. Feb. 8, 2007) ("The evidence presented at trial demonstrates that the Special Committee's decisions were borne *not of pretext* but out of a process in which the Special Committee could reasonably rely upon its counsel as to whether the evidence supported, both factually and legally, the decisions to terminate." (emphasis added)); *In re* PNB Holding Co. S'holders Litig., No. 28-N, 2006 WL 2403999, at *22 n.117 ("I perceive no basis in this trial record to conclude that the PNB directors intended to deal unfairly with the departing PNB stockholders; that is, that they in bad faith sought to underpay in the Merger.").

86. Del. Code Ann. tit. 8, § 141(e) (2001).

87. *Cf*. Selectica, Inc. v. Versata Enters., Inc., No. 4241-VCN, 2010 WL 703062, at *17–19 (Del. Ch. Feb. 26, 2010) (stating that "[u]nder § 141(e), where a board has relied on an expert's advice in making a decision, a due care claim challenging that decision must establish such facts as would make reliance on the expert opinion unreasonable," and finding the board's reliance on experts to be reasonable); Grubb v. Bagley, No. 13882-NC, 1998 WL 92224, at *2 (Del. Ch. Feb. 25, 1998) (stating that section 141(e) "affords a defense only if the board acted reasonably and in good faith").

88. *See In re* Walt Disney Co. Derivative Litig., 907 A.2d 693, 770 (Del. Ch. 2005) (directors entitled to protections of section 141(e) where they were informed "of all *material* information reasonably available"). Although not required, it is recommended that experts make a formal presentation to the directors who intend to rely upon the advice. *See id.* at 769 ("Nor is it necessary for an expert to make a formal presentation at the committee meeting in order for the board to rely on that expert's analysis, although that certainly would have been the better course of action."), *cited with approval on appeal*, 906 A.2d 27, 59 (Del. 2006).

89. *Cf*. Graham v. Allis-Chalmers Mfg. Co., 182 A.2d 328, 332 (Del. Ch. 1962) ("[W]hile there is no doubt, despite the terms of [section 141(f), which was the predecessor to section 141(e)], that corporate directors, particularly of a small corporation, may cause themselves to become personally liable when they foolishly or recklessly repose confidence in an untrustworthy officer or agent and in effect turn away when corporate corruption could be readily spotted and eliminated, such principle is hardly applicable to a situation in which directors of a large corporation, whose operation is hedged about with numerous and sometimes conflicting federal and state controls, had no reason to believe that minor officials in the lower echelons of an industrial empire had become involved in violations of the federal anti-trust laws." (referring to reliance on, and supervision of, corporate officers and employees)).

transaction.[90] Reasonableness of a director's reliance could turn, for example, on the source of the expert advice, the expert's familiarity and experience with the subject of the contemplated transaction,[91] or whether the subject of the expert advice raises novel or unsettled issues.[92] On the other hand, reasonableness of a director's reliance should not depend on whether a director should have known at the time of the reliance that the substance of the advice was flawed.[93] As long as directors reasonably rely on experts to provide them with correct advice, they should not be required to determine at the time of the reliance whether the advice is, in fact, correct.[94] To do so would unfairly require directors to act as guarantors of expert advice regarding subjects about which they admittedly are not in a position to exercise independent, unassisted judgment.[95]

90. *See Selectica*, 2010 WL 703062, at *18 ("In order to reasonably rely on Brogan, the Board needed only to find that Brogan was an expert in the matters to which he was providing advice and that he had been selected with due care. Brogan's work history as a tax attorney, CPA, and partner at several accounting firms specializing in tax accounting in the context of mergers and acquisitions, not to mention the dozens of Section 382 studies he had performed, gave the Board ample cause to consider him an expert qualified to speak on Selectica's NOLs and on the threat of their impairment."); *cf*. Union Ill. v. Korte, No. 17392, 2001 WL 1526303, at *11 (Del. Ch. Nov. 28, 2001) ("[T]he board was provided with no objective information [by the corporate officer] about how the stock price of $15 was arrived at, other than the ESOP valuation and sale to the Missouri directors, neither of which were indicators of the actual value of the shares. Therefore, the individual directors cannot rely upon § 141(e) as a prophylaxis against liability.").

91. *See Selectica*, 2010 WL 703062, at *18 (finding board's reliance on investment banker for limited purposes to be reasonable notwithstanding investment banker's non-expertise regarding related legal issues). In *Boyer* and *Valeant*, discussed above, the court suggested that it may be unreasonable to rely on expert legal counsel for advice concerning the fairness, from a financial point of view, of a contemplated transaction. *See supra* notes 45 (*Boyer*) & 55 (*Valeant*) and accompanying text.

92. *See In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 971 (Del. Ch. 1996) ("[T]he Board appears to have been informed by experts that the company's practices while contestable, were lawful. There is no evidence that reliance on such reports was not reasonable.").

93. *Valeant* appears to suggest that reasonableness of reliance may depend on whether a director should have known, on the face of a fairness report, that the substance of the expert's advice was flawed. *See supra* note 55 and accompanying text.

94. This principle might give way, however, where the expert advice is so flawed on its face that no rational director would believe it to be correct. *See, e.g.*, Brehm v. Eisner, 746 A.2d 244, 261 n.51 (Del. 2000) ("Th[e] protection [of section 141(e)], however, is not without limitation, as in a case of corporate waste."); Perlegos v. Atmel Corp., Nos. 2320-N & 2321-N, 2007 WL 475453, at *22 (Del. Ch. Feb. 8, 2007) ("[A] special committee's reliance on the advice of an expert cannot be said to be reasonable where the expert's work was so fundamentally flawed that directors were grossly negligent in relying upon it."); *In re* Walt Disney Co. Derivative Litig., 907 A.2d 693, 770 (Del. Ch. 2005) (finding that "the fault for errors or omissions in [the expert's] analysis must be laid at his feet, and not upon the compensation committee" and that the expert's "analysis was not so deficient that the compensation committee would have reason to question it").

95. A separate issue may arise where directors who are themselves experts in the subject of an expert's advice seek the protection of section 141(e). Under *Citigroup*, it appears that even directors with expertise are entitled to the protection of section 141(e). *See In re* Citigroup Inc. S'holder Derivative Litig., 964 A.2d 106, 135 (Del. Ch. 2009) ("[E]ven board members who are experts are fully protected under § 141(e) in relying in good faith on the opinions and statements of the corporation's officers and employees who were responsible for preparing the company's financial statements."). That protection, however, may be more limited than that afforded directors without expertise. For example, under the reasonableness inquiry, the Court of Chancery could hold the expert director to a "reasonable expert" standard and conclude that the director should have known on the face of the expert's report that the substance of the advice was flawed. Or, under the good-faith inquiry, the court could conclude that,

b. *Subjective Good Faith*

Under section 141(e), directors must act in good faith. Good faith is a subjective standard[96] which should depend on the directors' knowledge and the circumstances surrounding the expert's retention and the directors' consideration and approval of the transaction. Under this inquiry, it would be necessary to determine who selected the expert, the process under which the expert was retained, and what the directors knew with respect to the expert and the expert advice at the time of the reliance.[97] Good faith may be demonstrated, for example, where an expert is selected by a committee of independent directors. Bad faith, on the other hand, may be evident if the expert is interested in, or beholden to one who is interested in, the transaction.[98] Bad faith may also be evident if a controlling director or group of directors decides to pursue a certain course of action and then later retains an expert merely for the purpose of justifying the intended actions after the fact. Also, anything less than full disclosure by the directors to the expert of all material facts related to the subject of the expert advice might evidence bad faith.[99]

---

because the expert-director has specialized knowledge in the subject, the director could not have relied in good faith on the flawed expert advice. *See In re* Emerging Commc'ns, Inc. S'holders Litig., No. 16415, 2004 WL 1305745, at *39–40 (Del. Ch. June 4, 2004) (holding non-independent director with "specialized financial expertise" liable "because he voted to approve the transaction even though he knew, or at the very least had strong reasons to believe, that the $10.25 per share merger price was unfair").

96. *See In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 63–67 (Del. 2006).

97. *See Selectica*, 2010 WL 703062, at *18 (stating that the process under which the expert was retained did "not suggest anything untoward that should undermine [his] expert advice"); *see also Disney*, 907 A.2d at 770 ("[N]othing in the record leads me to conclude that any member of the compensation committee had actual knowledge that would lead them to believe . . . that [the expert's] analysis was inaccurate or incomplete. Without that knowledge, I conclude that the compensation committee acted in good faith and relied on [the expert] in good faith . . . .").

98. *See* Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1283–84 (Del. 1988) ("Under 8 *Del. C.* § 141(e), when corporate directors rely in good faith upon opinions or reports of officers and other experts 'selected with reasonable care', they necessarily do so on the presumption that the information provided is both accurate and complete. Normally, decisions of a board based upon such data will not be disturbed when made in the proper exercise of business judgment. However, when a board is deceived by those who will gain from such misconduct, the protections girding the decision itself vanish."); Sample v. Morgan, 914 A.2d 647, 669 (Del. Ch. 2007) ("The Committee's generosity, if it could be called that, might be thought to have arisen as much from the rapid action of a poorly-informed committee relying upon conflicted advice from a lawyer subservient to management rather than from a good faith exercise of business judgment."); *In re* Tele-Communications, Inc. S'holders Litig., No. 16470, 2005 WL 3642727, at *10 (Del. Ch. Dec. 21, 2005) (stating that special committee's use of experts who were already advising the corporation and its management "alone raises questions regarding the quality and independence of the counsel and advice received"); *see also* I Stephen A. Radin, The Business Judgment Rule 627 (6th ed. 2009) ("Courts are reluctant to defer to reliance by directors on the advice of financial advisors where the compensation to be paid to the financial advisor creates a conflict of interest. The most common example of such a conflict occurs where the advisor will receive a substantial contingent fee if a transaction succeeds . . . and the contingent fee is not linked to shareholder value.").

99. *See* Hawes & Sherrard, *supra* note 35, at 29 ("On one point the decisions unanimously agree: Reliance on advice of counsel will not be available to the defendant if he failed to disclose all relevant facts to the attorney.").

c. Reliance

Under section 141(e), directors must rely on the expert advice. Reliance in this context should be interpreted to require that directors follow the expert advice in all material respects, not just consider and reject the expert advice.[100] Of course, directors, not hired experts, are the ultimate decision makers, and they are free, in the exercise of their business judgment, to reject expert advice.[101] Under the common law, such bona fide consideration and rejection of expert advice may be considered as a factor in assessing the fairness of the directors' process. But where directors seek the protection of section 141(e), they should be required to prove that they relied on and followed the expert advice in all material respects. A contrary rule would defeat the purpose of the statute, which is to insulate directors from liability where they must depend on another to attempt to make an informed decision. By ignoring the expert advice, the directors, at least implicitly, would concede that they do not need the assistance of experts and are capable of understanding the issue and exercising independent, unassisted judgment.

The issue of reliance requires a fact-specific determination. For example, where directors follow the expert advice in all material respects, reliance will be apparent. On the other hand, where there is evidence that the directors settled upon a transaction price before considering the expert advice, even if the expert advice tends to support the directors' initial finding, there may be no reliance. Thus, the Court of Chancery should determine when the expert advice was received and the extent to which the directors considered or relied upon other factors or influences in setting the transaction price.

d. Causal Nexus

Section 141(e) should preclude liability only if the unfair aspect of the challenged transaction arose from the expert advice upon which the directors reasonably relied in good faith. If the unfair aspect of the transaction did not arise from the expert advice, there is no risk that the directors would be treated as guarantors of that expert advice. Like the issue of reliance, whether there is a sufficient causal nexus between the unfair aspect of the transaction and the subject of the expert advice will depend on the facts. A causal nexus could be proved, for example, by evidence demonstrating that the price of the transaction fell within the range of "fair prices" advised by experts. There may be no causal nexus, however, where,

100. *See id.* at 35 ("[T]he decisions have established the rather broad rule that in order to maintain the defense an advisee must have followed counsel's advice without material deviation."); *but see Disney*, 907 A.2d at 770 n.550 ("I believe it is important to understand that the compensation committee relied in good faith on Crystal's report and analysis even though they chose not to follow Crystal's recommendations to the letter. The role of experts under § 141(e) is to assist the board's decision-making—not supplant it. An interpretation of § 141(e) that would require boards to follow the advice of experts (substantially? completely? in part?) before being able to claim reliance on those experts would be in conflict with the mandate in § 141(a) that the corporation is to be managed 'by or under the direction of a board of directors.'").

101. *See, e.g.*, *In re* IXC Commc'ns, Inc. S'holders Litig., Nos. 17324 & 17334, 1999 WL 1009174, at *6 (Del. Ch. Oct. 27, 1999) ("no board is obligated to heed the counsel of any of its advisors").

with respect to a fairness opinion by a financial expert, the unfairness of the transaction relates to process (e.g., timing or structure) and not to price.

5. Section 141(e) Will Not Swallow Equitable Rules If It Is Applied in Duty of Loyalty Cases

The Court of Chancery expressed concern in *Valeant* that if section 141(e) provided a defense in duty of loyalty cases, it "would replace this court's role in determining entire fairness . . . with that of various experts hired to give advice to the directors in connection with the challenged transaction."[102] Under section 141(e), however, the Court of Chancery, or, in some cases, the Delaware Supreme Court, always remains the final arbiter of fairness. Section 141(e) is a statutory doctrine that provides circumstances under which directors will be "fully protected," which the Delaware Supreme Court has interpreted to mean "not held liable."[103] Section 141(e) does not instruct the Court of Chancery to consider defendant-directors' reliance on expert advice in determining the fairness of a challenged transaction. Entire fairness review is a common-law mechanism for scrutinizing

102. Valeant Pharms. Int'l v. Jerney, 921 A.2d 732, 751 (Del. Ch. 2007).

103. *See* Brehm v. Eisner, 746 A.2d 244, 261 (Del. 2000) ("[T]he question here is whether the directors are to be 'fully protected' (i.e., not held liable) on the basis that they relied in good faith on a qualified expert under Section 141(e) of the Delaware General Corporation Law."); *see also* Desimone v. Barrows, 924 A.2d 908, 937 n.98 (Del. Ch. 2007) ("Advice from professional advisors that they believed spring-loaded grants to be eligible for such treatment would be relevant in assessing the liability of directors."); Balotti & Finkelstein, *supra* note 28, § 4.15[B], at 4-110 ("Directors who rely in good faith on reports made by officers or outside experts are protected from liability."). That "fully protected" means "not held liable" is supported by section 172 of the General Corporation Law, which includes language nearly identical to section 141(e) and is titled, "Liability of directors and committee members as to dividends or stock redemption." Del. Code Ann. tit. 8, § 172 (2001); *see also* Klang v. Smith's Food & Drug Ctrs., Inc., No. 15012, 1997 WL 257463, at *5 (Del. Ch. May 13, 1997) (stating that "directors shall be protected from liability" if they comply with section 172). After the 1967 revision of the General Corporation Law, Professor Folk provided an example of how section 141(e) could serve as a defense to liability:

> Directors are jointly and severally liable for wilfully or negligently paying an unlawful dividend or for unlawfully purchasing or redeeming the corporation's stock. Liability runs to the corporation or, if dissolved or insolvent, to its creditors, for the total amount unlawfully paid or distributed. Directors held liable are entitled to contribution from other directors who would be primarily liable and to subrogate against stockholders receiving the unlawful payments or distribution with knowledge of facts indicating illegality.
>
> In such suits a director has the following defenses: . . . (c) that he relied in good faith upon the books of account or reports made to the corporation by any officer or by an independent certified public accountant or by an appraiser selected with reasonable care by the board, or relied in good faith upon other corporate records. (Sec. 141(e).)

Ernest L. Folk, III, The Red Book Digest of the New Delaware Corporation Law—1967, at 14 (1968) (internal citations omitted). An interpretation of section 141(e) that permits directors to rely on the advice of experts but does not fully protect them from liability in connection with that reliance ignores the statute's mandatory terms (i.e., directors "shall . . . be fully protected"). If the legislature intended section 141(e) merely to permit reliance on experts, it could have drafted the statute with permissive terms (e.g., directors "may rely . . .").

the fairness of self-dealing transactions[104] with only "a crude and potentially misleading relationship to the liability any particular fiduciary has for involvement in a self-dealing transaction."[105] Thus, section 141(e) should not be considered at all in connection with entire fairness scrutiny. Outside the motion to dismiss stage,[106] section 141(e) becomes relevant only once a transaction has been found to be unfair.[107] If a transaction is fair, director liability cannot be an issue and directors need not be "fully protected."[108]

This does not mean, however, that the Court of Chancery should not consider defendant-directors' reliance on expert advice under the entire fairness standard of review.[109] As the court held in *Cinerama*, "reasonable reliance upon expert counsel is a pertinent factor in evaluating whether corporate directors have met a standard of fairness in their dealings with respect to corporate powers."[110] It expressly

104. *See* Allen, Jacobs & Strine, *supra* note 9, at 1302 (explaining that because it is difficult in cases where a majority of the board is interested "to ascertain at what maximum price the transaction could have been effected in the market, the law imposes upon the directors the burden of showing that the transaction is entirely fair as to both process and price").

105. Venhill Ltd. P'ship *ex rel*. Stallkamp, No. 1866-VCS, 2008 WL 2270488, at *22 (Del. Ch. June 3, 2008).

106. *See supra* Part II.A.2. For the reasons discussed herein, section 141(e) should be available as a defense at the motion to dismiss stage, as it was set forth in *Brehm*, in both duty of care and duty of loyalty cases.

107. For an example of this analytical framework, see *Boyer v. Wilmington Materials, Inc.*, 754 A.2d 881, 898–911 (Del. Ch. 1999), where the court first held that the challenged transaction was not entirely fair, then assessed director liability, and finally considered, and rejected, the defendant-directors' section 141(e) defense.

108. *See* Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1134, 1142 (Del. Ch. 1994) ("I need not express an opinion on [the section 141(e) defense] as I conclude that in all events plaintiffs are not entitled to an award of damages on this record."); *cf*. Emerald Partners v. Berlin, 787 A.2d 85, 93 (Del. 2001) ("[W]hen entire fairness is the applicable standard of judicial review . . . injury or damages becomes a proper focus only *after* a transaction is determined *not* to be entirely fair.").

109. *See, e.g., In re* Loral Space & Commc'ns Inc., Nos. 2808-VCS & 3022-VCS, 2008 WL 4293781, at *22 (Del. Ch. Sept. 19, 2008) ("All aspects of the issue must be examined as a whole since the question is one of entire fairness."); Valeant Pharms. Int'l v. Jerney, 921 A.2d 732, 746 (Del. Ch. 2007) ("The court does not focus on the components individually, but determines entire fairness based on all aspects of the entire transaction."). *See also* Hawes & Sherrard, *supra* note 35, at 51 ("The defense of reliance upon advice of counsel has not received extensive treatment in the fiduciary duty cases. On the whole, those courts which have confronted the issue accept reliance as a factor tending to negate liability."). On this point, Hawes and Sherrard cite *Johnston v. Greene*, 121 A.2d 919, 925 (Del. 1956), "where evidence of the defendant's reliance upon legal advice was arguably a factor in the court's holding that the transaction was fair." Hawes & Sherrard, *supra* note 35, at 54 n.212.

110. *Cinerama*, 663 A.2d at 1142. The *Cinerama* court's consideration, outside the scope of section 141(e), of the defendant-directors' reliance is not inconsistent with section 141(e) because it does not appear that section 141(e) was intended to overrule or otherwise displace the common-law doctrine of reliance. *See* Graham v. Allis-Chalmers Mfg. Co., 188 A.2d 125, 130 (Del. 1963) ("At the meetings of the Board in which all Directors participated, these questions were considered and decided on the basis of summaries, reports and corporate records. These they were entitled to rely on, not only, we think, under general principles of the common law, but by reason of 8 Del. C. § 141(f) as well, which in terms fully protects a director who relies on such in the performance of his duties."); *see also* Lobato v. Health Concepts IV, Inc., 606 A.2d 1343, 1348 (Del. Ch. 1991) ("A statute will be construed as having changed the common law only where such a result is clearly indicated by express terms or by necessary implication from the legislative language used." (internal quotations omitted)).

found "the Technicolor board's reliance upon experienced counsel to evidence good faith and the overall fairness of the process."[111] Thus, although the Court of Chancery may, and should, give weight to reliance on expert advice when scrutinizing defendant-directors' process for entire fairness, that consideration should be pursuant to the common law, not section 141(e).[112] Although reasonable and good-faith reliance on expert advice is one factor indicative of fairness, that factor may be outweighed by other factors, including price, that render the challenged transaction unfair.[113] If, however, notwithstanding that unfairness, the directors complied with section 141(e), the statute should be determinative as to liability. It would therefore be possible for the Court of Chancery to hold that a transaction is not entirely fair (notwithstanding the defendant-directors' reasonable, good-faith reliance), but nevertheless shield the directors from liability under section 141(e).

111. *Cinerama*, 663 A.2d at 1142; *see also* Parnes v. Bally Entm't Corp., No. 15192, 2001 WL 224774, at *13 (Del. Ch. Feb. 23, 2001) (determining, in dicta, that transaction was entirely fair and noting under the fair dealing prong of entire fairness review that the directors relied on the advice of prominent investment bankers and experienced counsel throughout the entire process).

112. Similarly, although not determinative of reasonableness under *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985), or *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986), so-called intermediate scrutiny, reliance on expert advice should be considered as a factor in determining the reasonableness of a board's actions. For example, in *Goodwin v. Live Entertainment, Inc.*, No. 15765, 1999 WL 64265 (Del. Ch. Jan. 25, 1999), the Court of Chancery, under *Revlon* scrutiny, stated, "The fact that the Board relied upon expert advice in reaching its decision not to look for other purchasers . . . supports the reasonableness of its efforts." *Id.* at *22 (citing *In re* Vitalink Commc'ns S'holders Litig., No. 12085, 1991 WL 238816, at *12 (Del. Ch. Nov. 8, 1991) (board's reliance on advice of investment bank that no other bidder was interested supported finding that the board had a "reasonable basis" to conclude it obtained the best overall offer)); *see also* McMillan v. Intercargo Corp., 768 A.2d 492, 504–55 & n.55 (Del. Ch. 2000) (citing section 141(e) and stating that "[t]he board's reliance upon an investment banker (whose independence and qualifications are not challenged in the complaint) is another factor weighing against the plaintiffs' ability to state an actionable claim that the defendant directors breached their fiduciary duties by failing to secure the highest value reasonably attainable"). And in *Henley Group, Inc. v. Santa Fe Southern Pacific Corp.*, No. 9569, 1988 WL 23945 (Del. Ch. Apr. 12, 1988), where a board adopted a poison pill based upon the advice of its outside counsel, the Court of Chancery pointed to that reliance as a factor in concluding that, under *Unocal*, the board's perception of a threat was reasonable. *Id.* at *15; *see also* Selectica, Inc. v. Versata Enters., Inc., No. 4241-VCN, 2010 WL 703062, at *17–19 (Del. Ch. Feb. 26, 2010) (citing section 141(e) and finding that board's reliance on expert advice supported the reasonableness of their actions under *Unocal*); *In re* Gaylord Container Corp. S'holders Litig., 753 A.2d 462, 479 (Del. Ch. 2000) ("[T]he Gaylord board engaged in a rational deliberative process to define the threat it faced, meeting on two occasions and receiving detailed legal advice from a distinguished outside law firm. This supports the conclusion that the board acted in an informed manner." (footnote omitted)); Cheff v. Mathes, 199 A.2d 548, 556 (Del. 1964) (holding, pre-*Unocal*, that "directors, based upon direct investigation, receipt of professional advice, and personal observations of the contradictory action of Maremont and his explanation of corporate purpose, believed, with justification, that there was a reasonable threat to the continued existence of Holland"). As under entire fairness review, however, the Court of Chancery's consideration of defendant-directors' reliance on expert advice for the purpose of determining reasonableness should be pursuant to the common law, not section 141(e).

113. *Cf. In re* Emerging Commc'ns, Inc. S'holders Litig., No. 16415, 2004 WL 1305745, at *28 (Del. Ch. June 4, 2004) ("It is arguable that where . . . the merger price is found to be unfair, it would be difficult, if not impossible, for the merger to be found 'entirely fair' even if the process leading up to the merger involved fair dealing." (citing *Cinerama*, 663 A.2d at 1140 ("Plainly in a cash-out merger, price is a dominant concern, most especially where the buyer already has voting control of the enterprise, such as a parent-sub merger."))).

Moreover, where fiduciaries profit from unfair transactions, it is unlikely that section 141(e) would preclude the Court of Chancery from imposing equitable remedies. In such circumstances, it is difficult to reconcile section 141(e) with the general equitable principle that a "fiduciary is under a duty not to profit at the expense of those he represents."[114] Thus, if an interested-director transaction is found to be unfair, even if the defendant-directors reasonably relied in good faith on expert advice, the transaction would likely be subject to equitable remedies. Under this approach, directors who personally profit from an unfair transaction at the expense of the corporation may still be required in equity to return any profits to the corporation, effectively returning the directors to the status quo ante. For example, the Court of Chancery may retain its equitable power to enjoin a transaction,[115] or, under the doctrines of unjust enrichment[116] or constructive trust,[117] require interested directors to return to the corporation or stockholder class any profit received from an unfair transaction.[118] But if a director does not personally profit from an unfair transaction in which he or she is deemed to be interested,[119] or if the monetary damages to the corporation or the stockholder class exceed an individual director's profit from the transaction, section 141(e), if

114. Botney v. Teledyne, Inc., No. 5786, 1983 WL 21017, at *4 (Del. Ch. Nov. 22, 1983).

115. The Court of Chancery recently expressed doubt that section 141(e) could protect a "decision from being enjoined by the Court before it became effective." Transcript at 92, LC Capital Master Fund, Ltd. v. James, No. 5214-VCS, 2010 WL 892065 (Del. Ch. Mar. 8, 2010). In *David J. Greene & Co. v. Dunhill International, Inc.*, 249 A.2d 427 (Del. Ch. 1968), which was decided on a motion for preliminary injunction, the court did not address the issue because it rejected the section 141(e) defense on other grounds. *See supra* note 59.

116. Unjust enrichment

> is the unjust retention of a benefit to the loss of another, or the retention of money or property of another against the fundamental principles of justice or equity and good conscience. A defendant may be liable even when the defendant retaining the benefit is not a wrongdoer and even though he may have received [it] honestly in the first instance.

Ryan v. Gifford, 918 A.2d 341, 361 (Del. Ch. 2007) (internal quotations and footnotes omitted).

117. A constructive trust

> is a well established equitable remedy. It will be imposed "when the legal title to property is obtained by a person in violation, express or implied, of some duty owed to the one who is equitably entitled, and when the property thus obtained is held in hostility to his beneficial rights of ownership." 4 POMEROY'S EQUITY JURISPRUDENCE[] § 1044 (5th ed. 1941). Stated another way, a constructive trust "is imposed when a defendant's fraudulent, unfair or unconscionable conduct causes him to be unjustly enriched at the expense of anther to whom he owed some duty." *Adams v. Jankouskas*, 452 A.2d 148, 152 (Del. 1982). It is a remedial device used to transfer property to a plaintiff who can prove that he is equitably entitled to it.

In re Estate of Beekhuis, No. 11,853, 1992 WL 5689, at *1 (Del. Ch. Jan. 13, 1992).

118. If there is a distinction under section 141(e) between protection from liability for monetary damages and protection from equitable remedies, the Delaware General Assembly could amend the statute to state that directors "shall . . . be fully protected *from liability for monetary damages* . . . ," which would mirror the terms of section 102(b)(7).

119. *See, e.g., In re* Tyson Foods, Inc., 919 A.2d 563, 591 n.72 (Del. Ch. 2007) ("Not all acts of disloyalty or bad faith will directly benefit the malefactor, and a director may be held personally liable for a breach of the duty of loyalty in the absence of a personal financial gain."); Strassburger v. Earley, 752 A.2d 557, 581 (Del. Ch. 2000) (holding that directors may be held personally liable for breach of the duty of loyalty where they do not personally benefit from the breach).

applicable, should nevertheless protect that director from liability beyond the forfeiture of personal profit.[120] Thus, in *Valeant*, even if Jerney had reasonably relied in good faith on expert advice and the court held that section 141(e) provided him a defense to liability, he likely would have been required to disgorge the unfair portion of the $3 million bonus payment he received; he would not, however, have been liable for additional monetary damages flowing from his breach of fiduciary duty.

B. *PNB* and How Section 141(e) Could Operate as a Defense in Duty of Loyalty Cases

In *PNB*, the directors of a small bank in rural Illinois ("PNB") were held jointly and severally liable to a class of plaintiff stockholders who were cashed out in a merger that had the purpose of allowing PNB to reclassify itself as a subchapter S corporation.[121] After determining that converting PNB to an S corporation was the most desirable of several strategic plans, the defendant-directors retained a financial expert, Prairie Capital Services, Inc. ("Prairie Capital"), "to appraise PNB and determine the 'fair value' of PNB common stock."[122] That determination was necessary because, in order to become an S corporation, PNB could have no more than seventy-five stockholders and it was required to cash out several hundred stockholders.[123] Based on its analysis, Prairie Capital arrived at a value of $40.74 per share of PNB common stock.[124] About a month later, the entire PNB board met to consider and discuss Prairie Capital's valuation report.[125] "After discussion and a presentation by Prairie Capital, the board voted to accept the appraisal and concluded that $41.00 per share would be fair to the cashed-out stockholders."[126] The cash-out price represented a 12 percent premium over PNB's book value and a 6 percent premium over market value.[127] More than 90 percent of the shares of PNB common stock voted were voted in favor of the merger.[128]

120. For example, if four directors (constituting a majority of the board) sell a piece of jointly owned property to the corporation they serve for $100, which is based on their demonstrated reasonable and good-faith reliance on a financial expert, and the Court of Chancery later determines that the value of the property was $80 at the time of the transaction, each director could be required to return $5 (i.e., his or her share of the total unfair profit) to the corporation. However, if three of the four directors cannot repay the $5, the remaining director should not be jointly and severally liable to the corporation for the entire $20.

121. *In re* PNB Holding Co. S'holders Litig., No. 028-N, slip op. at 1 (Del. Ch. Sept. 19, 2006).

122. *In re* PNB Holding Co. S'holders Litig., No. 28-N, 2006 WL 2403999, at *5 (Del. Ch. Aug. 18, 2006).

123. *Id.*

124. *Id.*

125. *Id.* at *6.

126. *Id.*

127. *Id.* at *7.

128. *Id.* at *8. This figure represents "the aggregate vote of all PNB stockholders, including the directors and other stockholders who would remain in the S corporation. When looking at a vote of only those PNB stockholders who were not eligible to remain stockholders after the Merger, who held a total of 94,742 shares, 35,346 shares (37.3%) did not return a proxy, 46,224 shares (48.8%) voted in favor of the Merger, 5,846 (6.2%) dissented and sought appraisal, 4,066 shares (4.3%) voted against the Merger, and 3,260 shares (3.4%) abstained." *Id.*

In the later-consolidated appraisal and stockholder class action, the Court of Chancery held that the cash-out price was unfair.[129] The court applied the entire fairness standard of review, reasoning that the directors, as major stockholders who would remain stockholders following the merger, were interested in the transaction because "they stood to benefit personally if the price PNB paid [in the merger] was lower rather than higher."[130] Under entire fairness scrutiny, the court considered the testimony of the parties' expert trial witnesses and engaged in its own discounted cash flow analysis to determine that the fair value of PNB's common stock was $52.34 per share, or $11.34 higher per share than the plaintiffs received.[131] The defendant-directors were therefore held to be jointly and severally liable for the difference.

In reaching its holding, the court made the following observations:

- "At best, the board employed an investment bank to give them an opinion about the price to be paid. But that move, in itself, does nothing to invoke the business judgment rule."[132]
- "[A]lthough I do not find any evidence that the defendants consciously intended to pay an unfair price, the only procedural safeguard used was the employment of an investment bank to give a fairness opinion, and the record does not give one confidence that the work of Prairie Capital was a sufficient guarantee that a fair price was paid."[133]
- "In fairness to the defendants, I do make one observation about the question of their state of mind because of the possible implications it might have for their ability to seek indemnification from PNB or their D & O carrier. I perceive no basis in this trial record to conclude that the PNB directors intended to deal unfairly with the departing PNB stockholders; that is, that they in bad faith sought to underpay in the Merger. Any underpayment benefited PNB directly (as the purchaser in the Merger) and all its remaining PNB stockholders derivatively and equally, and did not inure exclusively to the PNB directors. In other words, although I find for structural reasons that the directors owed a duty of fair treatment to the departing minority, and fell short of meeting that duty, I do not find that they fell short out of bad faith. Rather, they simply missed the mark in attempting to set a fair price, perhaps partially because Prairie Capital did not perform a DCF analysis consistent with Delaware's § 262 jurisprudence."[134]

Although the defendants referenced section 141(e) in their post-trial papers,[135] the court did not rely upon or refer to the statute in its opinion. Having con-

129. *Id.* at *33.
130. *Id.* at *11.
131. *Id.* at *31.
132. *Id.* at *14.
133. *Id.* at *22 (footnote omitted).
134. *Id.* at *22 n.117.
135. *See* Defendant's Post-Trial Answering Brief at 24, No. 28-N, 2006 WL 2403999 (Del. Ch. Aug. 18, 2006) ("Defendants were entitled to rely on Prairie Capital's appraisal of PNB pursuant to 8 Del. C. § 141(e).").

cluded that the defendant-directors were interested and that entire fairness review governed its scrutiny of the challenged transaction, the court, consistent with Delaware jurisprudence, did not consider section 141(e). Moreover, because the court recognized that the ultimate issue was whether the defendants caused the corporation to pay a fair price,[136] the defendant-directors' demonstrated good-faith reliance on Prairie Capital's advice was of little import in determining fairness. The case is instructive, however, because it provides a factual framework for illustrating the current application of section 141(e) and comparing it with the approach advocated here. In *PNB*, (i) the directors were interested in the transaction, (ii) the court reviewed the directors' actions under the entire fairness standard of review, (iii) the court determined that the directors had acted in good faith, (iv) the unfair aspect of the cash-out transaction, its price, arose from the expert advice on which the directors had relied, which the court found to be flawed, and (v) the directors were held personally liable for the difference between the fair price and the actual cash-out price. Moreover, the court captured a tension that arises from the approach to section 141(e) advocated here: "[E]ven when acting in subjective good faith, a person who stands on one side of a transaction may not act fairly towards the person on the other side."[137]

Under the approach to section 141(e) advocated here, the *PNB* court's analysis, and perhaps its ultimate decision of whether to impose liability, would likely have varied in several respects. Under the approach advocated here, the court's determination that the cash-out price was unfair would not have ended the inquiry. Instead, after having determined that the defendant-directors faced a threat of liability for causing an unfair transaction, the court would have considered under section 141(e) whether the directors reasonably relied in good faith on the expert advice in setting the price. Although the *PNB* court did not expressly conduct this analysis with reference to section 141(e), it addressed the issue. First, the court found that the defendant-directors acted in good faith.[138] However, good faith, alone, is not sufficient to invoke the protection of section 141(e); the statute also requires reasonableness.[139] It is unclear whether the court in *PNB* considered the reasonableness of the defendant-directors' reliance on Prairie Capital. Although not framed as a review of the reasonableness of the reliance on Prairie Capital, the court seemed to imply that the reliance on Prairie Capital's valuation, to the exclusion of other potentially instructive information or advice, was unreasonable:

> [A]lthough I do not find any evidence that the defendants consciously intended to pay an unfair price, the only procedural safeguard used was the employment of an investment bank to give a fairness opinion, and the record does not give one confidence that the work of Prairie Capital was a sufficient guarantee that a fair price was paid.[140]

136. *PNB*, 2006 WL 2403999, at *22.
137. *Id.* at *12.
138. *Id.* at *22 n.117.
139. *See supra* Part III.D.1.
140. *PNB*, 2006 WL 2403999, at *22 (footnote omitted).

That observation does not necessarily imply that reliance on Prairie Capital was unreasonable because its valuation methodology turned out to be incorrect as a matter of law or because its ultimate calculation of fair value was not consistent with the court's; rather, the court may have been concerned that the directors relied solely on Prairie Capital's work to the exclusion of all other potentially instructive information, such as a second valuation by an advisor retained to represent the interests of the cashed-out stockholders. If the *PNB* court in fact determined that the defendant-directors' reliance on Prairie Capital was unreasonable, then, even if section 141(e) had been considered, the defendant-directors would not have been protected from liability. If, on the other hand, it was reasonable for the defendant-directors to rely on Prairie Capital's valuation to set what they believed to be a fair cash-out price, section 141(e) should have barred liability because the directors demonstrated that they acted in good faith.

If the Court of Chancery in circumstances identical to *PNB* were to find that the defendant-directors reasonably relied in good faith on expert advice, section 141(e) should preclude liability, but it may not entirely preclude recovery by the plaintiffs from the defendant-directors. As discussed above, section 141(e) acts as a bar to liability when its requirements are satisfied, but it may not preclude alternative equitable remedies.[141] Thus, if section 141(e) were invoked to preclude liability in circumstances identical to *PNB*, the defendant-directors may still have to disgorge any amount they personally received (albeit indirectly) as a result of the unfair transaction. For example, each director could be required in equity to pay the plaintiff class a percentage, equal to that director's percentage of holdings in the surviving entity, of the difference between the total amount paid to the plaintiff class in the merger and the fair value of the class's total holdings at the time of the merger. Put another way, if a plaintiff class is underpaid $100 in a cash-out merger, and Director A owns 5 percent of the surviving entity, Director A could be required to pay the plaintiff class $5, but he should not be held jointly and severally liable to the class for the remaining $95.

Aside from providing a helpful factual and procedural context from which to illustrate how section 141(e) could operate in duty of loyalty cases, *PNB* makes clear that the Court of Chancery is well suited to determine from the record and live testimony whether defendant-directors reasonably relied in good faith on expert advice in connection with a challenged transaction.

IV. Conclusion

Delaware law recognizes that directors are often compelled to rely on the advice of experts to manage the business and affairs of corporations, and that interested-director transactions can be beneficial to and necessary for corporations. Given these policies, the Delaware courts should reconsider the plain terms of section 141(e) and allow directors, whether or not they are deemed to be interested,

141. *See supra* Part III.A.5.

to assert section 141(e) as a defense to liability if the directors reasonably relied in good faith on expert advice but nevertheless produced an unfair transaction, as long as the unfair aspect of the transaction arose from the expert advice. The defense should therefore be available in both duty of care and duty of loyalty cases. Under this approach, directors who act with an honesty of purpose and reasonably rely in good faith on expert advice will no longer be required to serve as guarantors of that advice, which may be found in hindsight to have been flawed.